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Lending on Properties Leased to Oil Companies

The Experience of a Prominent Chicago Attorney in Dealing With Banks and Loan Companies in This Type of Transaction

By **EUGENE M. HINES**

WHEN an oil company leases a property, in nearly every instance the purpose is to acquire an outlet from which its petroleum products may be sold. The sale of other merchandise or the conduct of other lines of business on the premises, is incidental so far as the company is concerned.

Ordinarily, the oil company begins with the selection of a location on which a service station business is then being conducted, or the property may at the time be used for some other line of business. The property may be vacant, but so located as to be desirable for a service station. Negotiations for a lease are begun, and if a lease is entered into, the term is usually five or ten years; however, the term may vary as circumstances require. Frequently, an extension option and a purchase option are incorporated in the lease. The agreement of the parties as to the rate of rentals, the method of payment, and the respective rights and obligations of the parties, are also incorporated, to the end that the written instrument shall contain the entire agreement of the parties. If possible to do so, it is desirable for many reasons to incorporate in one instrument the entire agreement of the lessor and the lessee relating to the land.

Many leases provide that the service station structures and facilities are to be erected and installed by the lessor at his expense, pursuant to plans and specifications either prepared or approved by the oil company. Frequently this requires additional financing by the lessor, and when an application for a loan is made, the lease is an important matter to be considered by the loan company in determining whether it will in the first instance make the loan and, if so, the amount of the loan.

MAKING loans on properties leased, or to be leased, to oil companies is a subject that has no doubt caused many mortgage bankers some worry in the past because of the special problems involved. Mr. Hines analyzes some of these problems here. This article is a slightly condensed version of the remarks Mr. Hines made on the subject at the February MBA Board of Governors meeting in Chicago.

Frequently a loan is made in an amount and on a retirement plan providing for an assignment of rentals sufficient to liquidate the indebtedness within the lease term; in other words, the amount of the loan is based on the aggregate amount of rentals, less necessary deductions for insurance, taxes, and other current charges, which, if paid, will leave the premises free of any liens or encumbrances other than the mortgage which secures the loan.

I shall not go into the policy of loan companies with respect to loans on these service station properties, but will merely refer in general to certain provisions carried in leases on such properties, which are considered by the loan company when the loan is made. Obviously, the oil company requires the use of service station facilities as an outlet for the marketing of its products by the party who conducts the business. The oil company reserves the right of cancellation if, through no fault of its own, the location becomes undesirable or unsuitable. If such a situation comes about, it is usually because of the taking of a portion of the property for street widening or for some other public improvement. The lessor is usually compensated for any property taken, and the premature termination of the lease is a proper element of damage to be considered in fixing the award. This protects the landowner from financial loss if there should be a termination of the lease because of such governmental interference. The loan company's right as to applying the award towards the satisfaction of the loan, is the same whether or not there is a lease on the property.

A provision found in most leases, grants to the lessee the privilege of applying rentals to any indebtedness incurred by the lessor, or incurred by the lessee for the account of the lessor. I shall later point out why this is essential to the oil company and also beneficial to anyone to whom the property has been pledged as security. It is impossible to define in writing, or to foresee, every contingency which may arise during the lease term, and particularly the details of the obligation to keep the improvements in good condition and repair. Sometimes damage will occur which, if not repaired promptly, results in great hazard to the continuance of the business and also lessens the value of the property as security. In many cases, the lessor assumes the obligation to make the repairs but later refuses to do so or unreasonably delays the work. It is, therefore, essential that the lease carry a provision giving the oil company the right to make the repairs for the account of the lessor. If the oil company is forced to do this, it is entitled to prompt repayment by applying rentals as they accrue against the amount so expended. It should have this right even if necessary to continue the lease in effect beyond its original term, and many leases make provision for such possible extension.

Keep Property in Repair

The loan company may say that this appropriation of the rentals by the lessee deprives the loan company of the money which the lessor has agreed to pay towards the liquidation of the loan; but it should be remembered that if the property is not kept in good repair and suitable for the conduct of business, its value as security is diminished in much greater proportion than the amount expended to keep the property in good business condition. The payment of the loan may be deferred to the extent of the lessee's application of the rentals to the upkeep of the property but the security remains intact.

Here I should like to digress a moment to stress the fact that certain marketing equipment and trade fixtures, installed by the oil company for the use of the party who may conduct the business, are not to be included in the mortgage, even though the mortgage carries a provision including as security any equipment or fixtures subsequently installed. Oil companies are careful to protect their rights in this respect.

Where Disputes Arise

The leases provide that marketing equipment and trade fixtures remain the property of the oil company with the right of the removal of such equipment and fixtures at any time. If at the time the lease is taken there is an existing mortgage, it is the practice of the oil company to get something in writing from the mortgagee, recognizing the rights of the oil company in any equipment or property of any kind which it may erect or install during the life of the lease. Where the mortgage is junior to the lease, the loan company frequently fails to inform itself, by an examination of the lease, of the rights of the lessee in the marketing equipment and fixtures which may be located on the premises. If foreclosure proceedings are instituted, disputes are likely to arise between the oil company and the mortgagee or the receiver as to the ownership of this class of property. Difficulties can be avoided if there is a clear understanding between the loan company and the oil company as to the oil company's ownership and right of removal of property which, if there were no agreement to the contrary, would become a part of the realty and would pass to the mortgagee or anyone taking title through the mortgagee.

A great many leases contain an option, exercisable by the lessee, to extend the term of the lease for a stated period or periods. In addition to such extension option, leases frequently contain a purchase option or a purchase refusal. If the oil company elects to extend the term of the lease, it gives the lessor such notice of its election as the lease may specify, and the lease is thus extended for the specified term in accordance with the terms and conditions of the extension option. Sometimes the rental for the extended term is increased, sometimes it is less than the amount paid during the orginal term.

In the preparation of rental assignment papers it is essential to have them clear and specific as to whether the rentals for the possible extended or renewed term are also assigned. If it is the intention of the loan company that they shall be so assigned, the papers should so state in unmistakable language. If the oil company has any doubt, whatever, as to what was intended by the parties in the matter of assignment of rentals for either the original term or the extended or renewal term, it will not take any chances in the matter of payment. Its only safe recourse is to withhold payment entirely, and permit the loan company and the lessor to settle the matter between themselves. Such controversy may lead to litigation, in which the oil company becomes the stakeholder. Litigation is expensive for all concerned, and can be avoided if the transaction is in the first instance evidenced by instruments of writing in language susceptible to only one construction.

There is one thing which loan companies should especially have in mind in connection with the assignment of rentals for an extended or a renewal term: *Oil companies do not always exercise these options.* The station may not prove a profitable one. It was because of this business uncertainty that the oil company took the option for an extended term rather than to include that period of time in the initial term of the lease. It is wise to treat a lease with an extended or renewal term as one for the initial term only, and deal with the lessor on that basis.

Buying Mortgaged Property

There is a class of mortgages, not necessarily associated with a lease of the premises, concerning which some mention may be made. Oil companies, under purchase options or otherwise, frequently purchase property upon which there is an existing mortgage. Naturally the oil company insists upon a fee simple title or, at least, a good merchantable title. It is generally the practice of the oil company to have the notes evidencing the loan paid, and the mortgage taken for their security satisfied and released of record. Sometimes payment of the mortgage indebtedness is made out of the purchase price and, in such event, adequate notice is given to the mortgagee. Upon payment of the amount owing, the instruments evidencing the indebtedness are surrendered and the recording records cleared. It sometimes happens that the mortgagee, who regards his security as adequate and prefers to retain the mortgage as an investment, will refuse payment unless he is given a premium or bonus in some amount. If the oil company does not desire to meet the additional demand, it purchases subject to the

mortgage and assumes payment. The oil company experiences little or no difficulty in dealing with loans of this character.

At times oil companies are required to make advance payments of rents in substantial amounts. In some instances, such rentals cover a period beginning with the effective date of the lease and continuing to some specified time. In other instances, the advance payment may represent rental to accrue during some other period of the lease term. If such payments are made when the lease is entered into, they are clearly reflected in that instrument. More often, the payment is made under an agreement with the lessor entered into at some subsequent date, and is evidenced by an instrument supplementing the lease. In the event of such subsequent payment, the oil company takes the necessary steps to protect itself against claims of bona fide purchasers of the property or of third persons generally; but loan companies should inform themselves definitely whether or not there have been any payments of rents other than as specified in the lease. If there should be any doubt in the mind of the loan company, inquiry should be directed to the oil company, and negotiations with the prospective borrower should be discontinued until the loan company is in possession of all of the facts.

A Question of Priority

Where the borrowing of the money and the making of the lease are substantially contemporaneous in time, and are handled as one general transaction, frequently there is a disagreement between the loan company and the oil company as to which instrument is entitled to priority and which shall appear first on the recording records. Loan companies frequently insist that the lease be subordinated to the mortgage, while the oil company necessarily takes the opposite position. From the standpoint of the landowner and the oil company, the lease is the more important document, and is entitled to preference over the mortgage in the matter of recording. The loan company should offer no objection to the lease being given priority. The value of the land as mortgage security, is enhanced by the lease. From the viewpoint of the oil company, it cannot jeopardize its tenure for the full term of the lease because of the foreclosure rights existing in a senior mortgage.

Rentals Well Maintained

In many instances, the loan company will not make the loan until the lease of the property is assured; and this is true, whether or not there may be an assignment of rentals to the loan company to further secure payment of the indebtedness. If the lease or the rentals are assigned to the loan company, the logic of the loan company's position in insisting that the mortgage take precedence on the record, cannot be understood. If the rentals were wholly inadequate, it could readily be seen that under a foreclosure sale a lease with priority over the mortgage would reduce the sale price to the extent of the insufficiency of the rental; but it is not often that an oil company can rent property for less than its fair rental value. The rule is otherwise. It is believed that oil companies pay as high rents for locations suitable for their business as are paid by anyone else for whose business such locations would be suitable. It may be said that the oil company could bid in the property at the sale, but it must be remembered that the property has acquired a going concern value for a certain line of business, and competitors of the lessee oil company would not be hesitant to purchase the location and thus acquire the added business value of the property, which the purchaser had no part in creating.

I should also like to make reference to a question which frequently arises and which in my experience has been interpreted differently by representatives of the loan companies who desire to have lease rentals applied in liquidation of mortgage indebtedness. In some instances, the loan company insists on an assignment of the lease to it, thereby substituting the loan company for the lessor. I think there is no intention or desire on the part of the loan company to be substituted for the lessor and to assume all of the lessor's obligations under the lease. The rental is the only thing with which the loan company is concerned, and it usually develops that it is an assignment of the rentals only that the loan company wants. The acceptance by the loan company of an assignment of rentals, carries with it the obligation to apply the rentals on the lessor's mortgage indebtedness. The oil company is careful to see that the assignment papers are so drawn as to relieve it of any possible double liability for the payment of rent.

There is one problem which requires careful attention by the loan company if there is an assignment to it of lease rentals in connection with the loan. The question is whether or not the rental assignment must be recorded in order to protect the loan company against third persons who may acquire an interest in the property without notice of the assignment. The recording statutes of the several States vary as to whether or not such assignments must be recorded; and even under the statute of a particular State, assignment of future rentals for a certain length of time must be recorded to constitute notice, while the assignment of such rentals for a shorter length of time need not be recorded. Decisions of the courts of the several States, are also at variance in construing similarly worded recording Acts. The only safe rule that I can suggest, is to follow the statutes and the court decisions of the State in which the leased property is located. In the event of any uncertainty, the doubt should be resolved in favor of recording the instrument. If an instrument is to be recorded, I think the loan company should have it recorded rather than assume this will be done by the borrower or the oil company.

Assignment of Rents

I come now to a subdivision of this subject which is important to both the loan company and the oil company, but more important to you who make the loan. I refer to an assignment in part of rental installments; that is, an assignment which requires the lessee to break up the rental payment and pay a portion of it to you. Here is why the question is important:

You often make a loan and arrange to liquidate it with such partial assignment of rents, and do not obtain the consent of the oil company; in other words, you make the loan, pay out the money, and accept the partial assignment, which leaves you unprotected unless the oil company sees fit to give its consent. So far as I know, oil companies consent to these partial assignments; but, strictly speaking, an oil company would be within its rights to ignore a notice requiring it to split an installment payment as specified in the lease, and pay a part of the rent to someone other

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Watch Out for These Appraisal Errors!

These Are the Mistakes in Property Valuation That Lead to Trouble and Loss

By EDWARD V. WALSH

WE continue to hear the alibi that appraising is not an exact science but merely an *observational* science. Why it should be referred to as a science at all puzzles me. I do not know what sciences we use in appraising that are not used in any other activities —say, psychology, sociology, mathematics —and every line of business for that matter.

I suspect that it is *the opinion of many people inside and outside appraising* that, while prior to 1929 real estate appraising was more or less pure guesswork, we have since raised it to the dignity of *jumbled up scientific guesswork*. This, of course, is not true. I know many appraisers of the roaring 20's and the lugubrious 30's who can knock this opinion into a cocked hat.

I gather from some that appraising is a profession. From others I learn it isn't a profession. The latter insist it isn't yet ready for professional status—that outside of salaried appraisers for government bodies and a few companies, appraising is considered only as a sideline to be engaged in, intermittently, in connection with some other business, usually real estate. Yet I've known building material and roofing salesmen, policemen and street car men, who do appraisal work and believe me they are not bad at all!

One commentator recently called appraising a pastime—yes, a *pastime*. Here are the opening words of a recent article: "Appraising—the assignment of value to an item of property is a pastime in which anybody can indulge."

That isn't all I have heard about this business of appraising. I also learn that we are not the real appraisers—we're merely *interpreters*. The buyers of real estate are the real appraisers. They *set values* and all we do is learn their views and reiterate them as our own. Maybe this isn't so far wrong.

I also gather that, while we speak of three methods of appraising, there is really only *one*—the Comparative. The Capitalization method is comparison all the way through and the reproduction cost less depreciation, plus land value, commonly referred to as the Summation Value, is a hit-and-miss method when there is no building and sales activity, and a backward method when there is. They also declare that we appraisers fool around too much with mathematics and formulae—razzle dazzle technique, that we are too theoretical and take ourselves too seriously.

FRANK WILKINSON, in his article in a recent issue, makes it plain that from his investigation the mortgage companies that are keeping out of the red are those that have added appraisal, rental and other departments. In this article Mr. Walsh has some advice for mortgage men and others as to the type of appraisal errors to avoid. This article is a considerably condensed version of the original. Mr. Walsh is prominent in the affairs of the Society of Residential Appraisers and for the past six years has been assistant state appraiser for the HOLC in Illinois.

All this confusion is not good for appraising. We know what we are—we know what we are doing and what we are endeavoring to accomplish. We are in a legitimate business which we are trying to conduct in an honest and competent way.

These are particularly troublesome, turbulent times. Another World War is getting underway.

We have been told that, as a result of the War and recovery, employment will increase by the thousands, families will undouble, vacancies will go down to nothing, rents will rise, commodity prices will shoot up, and further that labor, materials and building costs will mount. We are told that all this may affect new building and we may find it difficult to compete with standing buildings. Inflation will come—then regimentation. The government will dictate who may purchase a home and what the buyer may pay for a property.

As appraisers, certainly we must look ahead—we must be keen, alert students of developments, constantly on the *qui vive*. Our advice and counsel will be sought more than ever before. Our duty and responsibility to our client is grave. Watch out lest you be *put on the spot*.

You say: "Why get excited about these things? All we can do is set the value on a property as of the time of the appraisal. No one knows what tomorrow may bring." There's the paradox. We have been selling the general public on the idea that we are more or less *delvers into the future*. We tell our client: "I am giving you my opinion today of the present worth of the future benefits to be derived from this property." The client is led to believe the appraiser can gauge the future.

I have learned that, while the vast majority of appraisers can strike within 10 percent of one another in valuing standard properties—frame and brick bungalows, residences, two - three - and four-apartments, and other small income properties in standard districts, we often differ 25 percent to 100 percent, and more, in appraising non-standard, unusual, so-called problem properties, *even when there is but one possible purpose to the appraisal*.

You know the properties I speak of—they are found everywhere, not only in slum, blighted areas, but in high-grade residential districts, in the apartment zoned districts, on business streets, and on the streets where the business of the town or district is stretching out its tentacles into the residential areas.

Assign one appraiser to each of six properties, any six. Let each value the

properties independently, no collaboration—none of this "What-did-you-get-on-the-land-value?" or "How-much functional - and - economic - depreciation-did-you-give-it?" Let's do this on the up-and-up. Let's bring in our findings, treat these as clinic properties in one combined group and endeavor to determine *where we aren't thinking alike*. Maybe we are expecting too much in hoping to get within 10 percent of one another on such properties. I think that on such properties, it is permissible to be 25 percent divergent. *I do not believe we should be 100 percent off*. We *can* narrow that gap.

Real Uniformity Needed

Appraisers strive for uniformity in appraisal reports, forms, terminology, ethics, fees. Here's a place where *real uniformity* is needed.

What can we do to level off overvalued districts, where the zoning is creating a hardship on residential properties, where taxes and interest are eating up values, halting the sale of properties, preventing them from being maintained properly. Business zoned streets—full, half and quarter section lines, zoned for miles for business where, by no stretch of the imagination, can one visualize concentrated business for generations, if ever.

We must bring pressure to bear on authorities to re-zone at least portions of these districts and streets to permit a profitable use. There will be objections from poor, deluded hopefuls—owners (the few that are left) who are waiting for that $1,000 a front foot for their lots. They will object, but the greatest good for the greatest number must prevail.

Appraisal groups should work in unison on this. What aid and advice can we give in arresting the downward trend of districts still considered fairly good?—districts with everything a community needs going to the dogs. The "shame of it," we say, but that is as far as our interest goes.

We see the high maintenance and tax cost striking at the heart of value. We seem to be stymied in prescribing remedies. This is outside the realm of the appraiser—it is too altruistic. As appraisers, we merely take things as we find them. I say that *value* is to the appraiser as the human body is to the physician and we *must* be interested.

Let us consider some phases of appraising where we are not serious enough, where we take *too much* for granted.

I am not going to mention as errors, the selection of a 28c cube where it might be 26c or 30c. I am not going to quarrel with a cube content that is out a few cubic feet on a small building or a few hundred cubic feet on a large one. I will not say anything about the selection of a 7 percent capitalization rate where perhaps 6 percent or 8 percent is more correct.

Inadvertent errors in capitalization can be, and often are, compounded and sometimes produce a summation value or capitalized value way out of disproportion with the comparative value.

I do mention such errors as occur in the income, expense analysis as too little or too much deduction for heat, decorating or other expense items, or where some item is left out entirely that should be in. These are errors which produce an erroneous, fictitious net and therefore, a wrong value. The errors I wish to stress are those due strictly to carelessness.

Too many so-called good appraisers run the chance of appraising properties by street address alone without checking the legal description. In many cases they get by. But I have seen many where failure to check the legal description has resulted not only in most embarrassing mistakes, but costly ones. It is too much trouble to go to the Real Estate Board's plats, or those of the City or County, or to the local real estate broker. "The owner will give me the dope", they say. In as many instances, the property is not even owner-occupied.

Your Client Wants to Know

Important easements and encroachments, self evident party walls, common user agreements are often missed. Sometimes they are not easily determined but when there is doubt whether the garage or fence encroaches a few inches, mention it. Despite the fact that you try to cover yourself on your limiting conditions—that you are not responsible for matters of a legal nature—they may be invaluable information for your client.

Many so-called good appraisers often value properties without inspecting the interior—a very bad error. You might have made several attempts to get in but no one has been home so you take a chance.

"Oh, it's one of that kind. I've seen hundreds of them. Wish I could see through those curtains though, but I can't. Basement windows are so dirty I can't see through them," runs the line of reasoning.

Witness Stand Jitters

Often you will miss structural defects, cracks in the foundation wall, evidence of poor footings, inadequate joists, cracked plaster, leaky roofs, and a dozen other defects which must be seen to be appreciated. You may miss the heat, hot water instead of hot air, steam instead of hot water and, while this may make very little, if any, difference in your value, it may discredit you in the eyes of your client. If the case ever gets into court, it may cause you some worry on the witness stand and cause your testimony to be thrown out.

No matter how many times you've seen a property, if it is a court case, try to go through it again before you go on the stand.

Appraisers often neglect to mention the zoning and restrictions—often very important. A client of yours is considering the purchase of a home, the first one he has bought. Interest is centered on that house. The man is thinking about that work bench he will have in the basement and never could have in his apartments. His wife is thinking how she will handle her new drapes. They both want to make sure of the purchase price. They call you in for advice for which they are willing to pay. You appraise the property and the value you obtain is close to the asking figure. You haven't said a word about zoning. You have not told them what use may be made of that vacant lot next door.

They buy the property, live in it for a year and then up against them goes a three-flat, shutting out light, air and sunshine. They dig up your appraisal—not a *word* about zoning. They don't think so much of you now as an appraiser. They should have had sense enough to know? Well, the funny thing is, a whole lot of them *don't*. Call them uninformed buyers, if you will. When you are appraising, it's your duty to *make them informed*. You have no other choice.

Appraisers often submit poor photos of the subject property itself and insufficient views of properties adjoining. They may neglect to show contiguous or adjacent detracting influences such as gas stations, public garages, exposure

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to business, across from a school, near railroad tracks or dump, etc.

Comparative Prices Vital

I saw an appraisal recently where the pictures submitted showed a row of fairly good looking shirt-front bungalows. There was an X-marks-the-spot over the subject property on the picture. The value appeared to be substantially correct. No comparisons were given so it was spot checked by a man acquainted with the district in general. He contacted nearby brokers as to listings and sales. It was found that identical and similar buildings in the block sold recently, and were listed for sale, at $500 to $750 less than this property, due principally to the fact that the whole block on the other side of the street was given over to a Ward office and parking lot for city trucks which the appraiser neglected to show in his photos. The unforgivable part was that he failed to mention it in his report and failed to penalize the property with economic depreciation because of the existence of that detracting influence.

Appraisers often fail to give comparative sales and listings and when they do, they are often not comparable.

Give comparison as close to subject property as possible in proximity and type. If you are appraising a two-story brick residence, don't quote the sale or listing of a frame cottage 10 miles away. If you are appraising a 12 or 15 modern apartment in an exclusive section, don't quote a 48 year old 12 or 15 apartment building in a colored district. If you do quote comparisons of properties blocks or miles away, state how the districts compare.

Your client, whoever he is, is interested in the listing or sales of properties identical or similar. If your comparison is not exact, state in what particular it differs and what, in your opinion, is the difference in value above or below subject property and why.

Appraisers fail to give a good word picture of property and its environs. Your out-of-town client is interested in knowing the type and kind of surrounding improvements—the income level, the type and class and racial occupancy, etc. Even in your low cost check sheet appraisals, you should add at least a line or two of comment, merely to say, "This is a typical stone front two-flat in the west side of X-ville."

Appraisers fail, even when checking the legal and lot size, to show the land dimensions in their report, especially in those reports where they are not required to show a plot plan. This is very important.

They fail to mention brick veneer as against solid brick—important for insurable purposes.

They fail to describe the garage, whether it has sewer, water and lights or heat (sometimes from main building). They fail to mention whether rents set up include garage and which apartments (if there are more apartments than there are garage stalls) have garages. It is only a matter of $2.50, $4.00 or $5.00 but it counts in that income expense analysis.

Safety First Always!

Appraisers fail to break down the annual income into monthly income by units in two or more unit properties. Your client wants to know the fair income and the fair rent for each individual unit. Very often, the units have different rentals.

Appraisers fail to mention the land improvements such as sewer, water, gas, electricity. He assumes the client knows whether these are in or not. Sometimes they are in the street and not brought into the property which has septic tank, unknown to the new buyer.

These are some—only *some*—of the mistakes appraisers make. The remedy for them is as simple as ABC and it isn't original with me.

It's simply: safety first.

Let that be your slogan in appraising.

HOLC borrowers have saved $300,000,000 to date on interest alone—the difference between the HOLC rate and the one they paid on their previous mortgages, says the FHLBB press department.

SAYS BUY REAL ESTATE FOR TRUST FUNDS

Outright purchase of income producing real estate, to be held as part of the assets in a trust fund, where its terms permit such a course, was recommended by Ben W. Utter of the Title Guarantee and Trust Co. of Los Angeles at the ABA Mid-Winter Trust Conference.

He declared that most real estate held in a trust fund acquired either through the original trust instrument or through foreclosure of mortgages is not satisfactory as part of the trust, while income-producing property purchased especially for the trust can be of material help to trust officers in securing income for the trust's beneficiaries.

He said outright purchase of real estate after a careful study of the property as an income-producing part of a trust can be wisely made.

"If we do this, we shall at least acquire good real estate. We shall select high-class property producing an adequate income. If the job is well done, perhaps our beneficiaries will fare quite as well as they would if we confined our investments to other media. In this connection it is interesting to note that many of the life insurance companies have begun to make fairly substantial investments in real estate.

"Officials of some life insurance companies assert that the ownership of real estate provides an opportunity for control and intelligent management of the property that is otherwise lacking in investments in real estate mortgages until the difficulties have been incurred and the property acquired through foreclosure.

Mortgages a Proper Medium

"It is further stated that with respect to a mortgage there is practically no opportunity for increase in its value, whereas in the case of real estate owned outright there is always the possibility of an appreciation in value. It is also urged that real estate should be considered a proper investment at least in those cases where common stocks are considered, for while both classes of investments are subject to appreciation and depreciation, neither the rise nor fall in value of real estate is quite so breath-taking as that of common stocks.

"My conviction is that both mortgages and real estate furnish perfectly proper media for investment of trust funds, when and only when they are subjected to the same careful tests which are now applied to other securities.

"Trust institutions should organize statistical departments whose sole business is to acquire and assemble useful information and make it available in a practical way to the personnel charged with the responsibility of making mortgage loans and disposing of undesirable real estate," he asserted.

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Inheritance Taxes and Real Estate

The Federal inheritance tax levy is destroying the incentive for investment of large capital in real estate. The Federal inheritance tax department takes the assessed value on property as the basis for its tax levy—but city valuations, in many, many cases, are known to be too high. Hence an injustice is done the estate. People are afraid of large investments in real estate.

These conclusions are set forth by Edwin J. Rosenbaum, real property economist, who says:

"The administration of these taxes has shut off what might be a flow of investment capital into a depressed realty market; and they contribute further to the destruction of real estate values.

"The actual imposition of these taxes in the present realty market frequently leads to virtual confiscation of the real estate whether or not equities are involved or the properties are unencumbered. In fact, there is not only confiscation of the equity, but often the estate suffers a deficit above the taxes when the property is finally sold. The 20 percent tax frequently becomes a 40 percent and 60 percent tax.

"The manner in which this extortion is accomplished is very simple, but none the less high-handed and arbitrary.

"Upon the death of the owner of a large estate, the attorneys or the trust company, through their attorneys, have sworn appraisals of the various properties made and sent to Federal and state inheritance tax departments.

"The Federal inheritance tax department then sends out a field agent to appraise the properties. Evidently under instructions that flow from Washington, the field agent appraises the properties usually at or near the value fixed for city or county tax purposes. In other words, the Federal authorities attempt to extort taxes from the heirs, not on a basis of present-day values, but on a basis approaching the inflated prices that existed for a few short years during 1926-'29. Naturally the state authorities always accept the Federal valuations.

"The lawyer or the certified public accountants for the estate then attempt a compromise and taxes to be imposed become a matter of 'horse trading' with the Federal authorities. The estate representatives and experts may carry the tax claims to Washington or further through the courts, but there is little real redress from the courts.

"Some of the results from this brutal procedure are these. Capable lawyers advise their clients not to buy real estate because of inheritance taxes; properties are thrown on the market to realize cash to pay these taxes, large properties are offered for sale at sacrifice prices in contemplation of death because of the death taxes. The necessity for an estate to be kept constantly in a highly liquid position to meet the imposition of any possible death taxes becomes absolute.

"Large country estates are frequently made a present to the community. There is no philanthropy involved in this; it is the natural desire to guard heirs against inheriting a liability."

LENDING ON PROPERTIES LEASED TO OIL COMPANIES

(*Continued from page 3*)

than the one designated in the lease to receive it. It is true that there are certain exceptions to this rule. The rule stated obtains at law, but the circumstances may be such that the principles of equity can be invoked to sustain such partial assignments.

The reason obtaining in law for refusing to enforce a partial assignment is, if given effect, that the debtor would be deprived of the right to pay his debt *in solido*, and may be subjected to many actions, embarrassments and responsibilities not contemplated in his original contract. This rule does not apply in equity where the procedure contemplates that all persons at interest should be made parties and have their rights determined by a single decree. It is not necessary to point out here the distinctions between relief which may be had in courts of law and in courts administering equitable rules and principles. No good purpose would be served in endeavoring to put before you hypothetical states of fact, under which a partial rental assignment would be upheld by the courts administering equitable relief. No party to the transaction wants to be forced to go into court for the enforcement of his particular rights. As suggested before, there is one sure and easy way to avoid controversy and that is, to procure the express consent of the lessee to your assignment, and to make the lessee a party thereto in such way that the rentals will be apportioned in the manner desired by the loan company and the borrower.

The policies and principles upon which mortgage bankers protect their loans originate within their business, and this is as it should be. They know best what precautions they must take to assure the repayment of the loans within the time and in the manner in which the borrower has obligated himself to pay. On the other hand, third parties having an interest in the mortgaged property, have an equal right to protect such interest to the extent of the full value thereof. It is believed that every party in interest can fully protect his rights without infringing upon the rights of the other parties. The adequate security which you require for your loans, is in no wise lessened by a better understanding on your part of the rights of others who are directly and financially interested in one way or another, in the contract between you and the borrower. It is possible for all concerned to give friendly and helpful cooperation. In that way, the problems which confront you can be more easily solved and perhaps, in some instances, eliminated entirely.

The views I have expressed here are my own, and not necessarily those of any oil company. It is not at all likely that all the many oil companies do business in the same way. Their representatives who handle the matters of which I have spoken, may entertain views different from mine, and their procedure may not accord with my experience as to how these matters can best be handled.

March 15, 1940

Association ACTIVITIES

★ NEWS OF WHAT'S HAPPENING AMONG MBA MEMBERS AND OUR LOCAL ASSOCIATIONS

Why Not Hold a Farm Mortgage Clinic?

By **GEORGE H. PATTERSON**

The success, both in attendance and interest, of the first MBA Mortgage Clinic held in Chicago, would seem to warrant further similar conferences.

There is reason to believe that a considerable group of MBA members who have had experience with and are interested in the farm mortgage business, would favor holding a meeting in which the questions and discussions would be directed entirely at the farm loan field.

As the flood of problems came in, in reply to the questionnaire sent out for the Chicago meeting, it became apparent that our Chicago Clinic would be strictly a city mortgage conference. As it happpened, practically all those attending were city mortgage men.

A number of questions were submitted, however, bearing upon the farm mortgage business. Inasmuch as these pertained to matters of rates, advertising, competition and general mortgage practice, it was found possible to deal with these questions as though they had been directed toward the city business.

There was one significant exception: One farm question was submitted, so broad in scope, that it was not thought possible to discuss it on the floor. It was:

"Is it possible for the life insurance companies to recapture and hold their share of the farm mortgage business of this country?

"If the answer is 'yes', how can it be done? If the answer is 'no', does that, in itself, indicate a threat to all mortgage business?

"Is continued delay in attempting to regain this business an invitation for prolonging Government lending and Government control?"

This question was submitted to a small group of mortgage men who discussed it at length and, from the floor, made this reply:

"We believe the answer is 'yes'. We further believe that with more time to consider the subject and with a larger number of experienced farm mortgage men in attendance practical methods can be worked out to recapture and hold the farm mortgage business for the private lender. While we are aware that a few life insurance companies are seeking farm mortgage loans in limited territories, our understanding is that the total holdings of farm mortgages by the life insurance companies continues to decline and we believe that this is an encouragement to the Government lending agencies to increase and enlarge their activities and that in this there is the danger that Government lending will make further inroads on the city mortgage business."

This group has asked President Shutz for the appointment of a committee to consider the advisability of holding a Farm Mortgage Clinic similar in its program to the City meeting but located more centrally in the farm loan territory and, if practical, in connection with the next meeting of the Board of Governors.

SHALL MBA sponsor a Farm Mortgage Clinic? What do our farm mortgage lenders think of the idea? We shall greatly appreciate their views. The first Mortgage Clinic, which, as Mr. Patterson explains, was devoted almost entirely to city mortgage problems, was one of the most successful meetings the Association ever held. Would not one devoted to farm mortgage problems prove just as helpful? If you think so, advise us immediately, indicating WHEN it should be held and WHERE.

MEET APRIL 12 TO ORGANIZE ILLINOIS MBA

The organization for the Illinois Mortgage Bankers Association has been called for April 12th at the Pere Marquette Hotel in Peoria when it is expected that the scope of the new group's activities will be defined and officers elected. Secretary George H. Patterson said that the group will seek to represent the state in mortgage banking matters as the CMBA does for Metropolitan Chicago.

The organization committee consists of Maurice A. Pollak, vice president and secretary of Draper & Kramer, Inc. of Chicago; M. B. Stine, First National Bank, Danville; A. J. Stevens, Joliet; A. H. Seise, Northern Illinois Mortgage Co., Rockford; A. E. Streitmatter, Alliance Life Insurance Company, Peoria; W. C. Rainford, Mercantile Mortgage Company, Granite City; E. S. Waldmire, Bernard Investment Co., Springfield; and Hudson Burr, Hudson Burr & Co., Bloomington. Preliminary plans were made by this committee at a meeting in Springfield.

Mortgage bankers all over Illinois are being invited to join with the group in organizing the new association.

One of the primary objectives in organizing on a state-wide basis is the fact that in the past mortgage bankers over the state have not had an organization through which they could voice their views on state legislation and other matters of general interest to mortgage lenders.

CLINIC FOR MBA

How do your competitors get their business—by advertising? By solicitation? The Chicago MBA is making this the theme of a special Advertising Clinic on March 21. A. Campbell MacIsaac, real estate editor of the Chicago Herald-American, will speak on newspaper advertising, Stephen G. Cohn, director of public relations of Dovenmuehle, Inc., will speak on direct mail and Earle Vincent Johnson of Republic Realty Mortgage Co., will talk on personal solicitation.

The meeting will be limited to CMBA members.